IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. 9

UNITED STATES OF AMERICA,
Appellant

v.

SEALY, INC.,
Appellee

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS

BRIEF FOR APPELLEE, SEALY, INC.

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December 22, 1966

MCCORMICK AND HENDERSON, INC., CHICAGO

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OPINION BELOW

The district court's findings of fact and conclusions of law (R. 63-152) are unofficially reported in 1964 TRADE REG. REP. ¶71,258 (N.D. Ill.).

QUESTION PRESENTED

Sealy, Inc. (hereinafter "Sealy"), owning trademarks and patents and possessing processes and know-how for the manufacture of bedding products, is the successor in interest of a bedding manufacturing concern which sold certain of its manufacturing plants and licensed the purchasers thereof to continue manufacturing and selling under the name "Sealy" within specified areas, and thereafter granted similar licenses to a number of bedding manufacturers in

other areas. Are the territorial restrictions of Sealy's licenses illegal per se under Section 1 of the Sherman Act, without regard to their business purpose or overall competitive effect — and notwithstanding the fact that Sealy's licensees are unrestricted as to the areas in which they manufacture and sell their own-brand products— simply because the Sealy licensees, in the aggregate, own substantially all of Sealy's common stock?

STATEMENT

On this appeal, the Government seeks to expand the limited categories of arrangements classified as per se violations of the Sherman Act. Although the decision in this case will directly affect only the bedding industry of the United States,[1] acceptance of the Government's arguments would have a widespread effect upon the business community as a whole and disastrous consequences for the "franchise movement" and the multitude of small businessmen engaged therein.

This case reaches the Court in a peculiar posture. Pretrial and trial were carried out on the Government's theory that the territorialization allegations of the Complaint charged a "hard-core" violation of Section 1 of the Sherman Act, *i.e.*, that "Sealy, Inc. is no more than a facade," or a "front," which was "created and used [by the licensees] . . . to camouflage their own collusive activities under

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[1] United States v. Serta Associates, Inc., Civ. No. 60 C 843, N.D. Ill., is a companion action similarly challenging the territorial restrictions of the Serta concern and its bedding manufacturer licensees. Serta filed a brief amicus in this Court in White Motor Co. v. United States, 372 U.S. 253 (1963). Like proceedings against Restonic Corp. and Spring-Air Co. were settled by consent judgments, as noted in Brief for the United States, pp. 2-3, n.1 [hereinafter cited "GB ...."].

a trademark umbrella."[2] But on this appeal, the Government abandons this theory, stating that it does "not argue that Sealy, Inc. was no more than a facade for a conspiracy to suppress competition . . ." but that, by reason of the licensees' stock ownership in Sealy, "competition has *in effect* been eliminated by the action of the competitors themselves" (GB 12; emphasis added). Thus, the Government charges a kind of "constructive conspiracy" for which it would have this Court create a new class of per se offense.

The Government's evidence at the trial consisted of hundreds of documents—substantially all from the files of Sealy. The Government offered no evidence to show that the challenged licenses in fact restrained the bedding trade. At the conclusion of the Government's case the court denied Sealy's motion to dismiss but stated its opinion that the evidence on the division of territory issue failed to prove that Sealy's relationship with its licensees constituted a conspiracy in restraint of trade.[3] The court thereafter heard defense evidence on the resale price maintenance charge and, at the close of the evidence, it granted Sealy's renewed motion to dismiss the territorialization charge. It found that:

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[2] Plaintiff's Reply and Answering Brief, etc., p. 35, April 17, 1961; Plaintiff's Brief in Opposition to Defendants' Briefs, etc., pp. 12, 14-15, Oct. 12, 1961. See also Government's Post Trial Reply Brief, p. 8, July 2, 1964 (Sealy is "nothing more than a 'corporate veil' under the egis of which various independent bedding manufacturers . . . allocate territories"), and notes 20, 21 *infra*.

[3] The district court denied defendant's motion because the territorial charge was included in a single-count Complaint with a resale price maintenance charge (see R. 15, 18). The court held for the Government on this latter charge, and no appeal has been taken from this part of the district court's judgment, which the Government has said contains "an appropriate injunction" (Jurisdictional Statement 6). It should be noted that this case involves no question of price fixing on sales by licensees *to* dealers.

"Plaintiff's evidence, read as a whole, conclusively proves that the Sealy licensing arrangements were developed in the early 1920's for entirely legitimate business purposes, including royalty income to Sugar Land Industries, which owned the Sealy name, trademarks and patents, and the benefits to licensees of joint purchasing, research, engineering, advertising and merchandising. These objectives were carried out by successor companies, including defendant, whose activities have been directed not toward market division among licensees but toward obtaining additional licensees and more intensive sales coverage" (Fdg. 119, R. 104).

The relevant facts, as shown mainly in the district court's findings and the Government's own exhibits, fully support the court's ultimate finding and demonstrate the lawfulness of the purpose and the procompetitive effects of the Sealy licenses.

A. Sealy and Its Business

For more than forty years, Sealy and its predecessors have been engaged in the business of licensing for royalties relatively small bedding concerns to manufacture and sell under the Sealy name and trademarks in different parts of the United States; it also furnishes to the licensees technical and managerial services and develops and carries out advertising and merchandising programs. Sales of bedding by the thirty Sealy licensees in 1959 were $58.6 million, and royalty income to Sealy was $1.4 million (Fdgs. 11-14, R. 66-67; Fdg. 119, R. 104). Contrary to the Government's Statement (GB 7), not the "income" but the annual "gross sales" of individual licensees ranged from a low of $533,000 to a high of $6.5 million during the years 1957-1959; the great majority of the licensees had sales between $1 million and $3 million (Fdg. 14, R. 67). The Government concedes that "the relatively few manufacturers who compose the

Sealy system . . . in the aggregate compose but a small segment of the bedding industry" (GB 15).

The district court found that as to their own-brand products the licensees are unrestricted as to territory, and the Government conceded that they can and do sell such products outside their Sealy territories (Fdg. 27, R. 72; R. 12).

Since a reorganization in 1933 when the present Sealy was incorporated, it has continued the kind of activities which had been engaged in by its predecessor, Sealy Corporation, *i.e.*, procurement of new licensees and expansion of sales coverage; engineering and research for production, specifications, and quality control;[4] trademark matters; accounting procedures; standardization of purchasing; and advertising, merchandising, and sales promotion services (Fdgs. 36-38, R. 75-76).[5]

Much of Sealy's effort has been in the area of advertising and merchandising; its advertising budget rose from $483 in fiscal 1935, to $846,920 for fifteen months in the years 1957-1958, to approximately $1,000,000 annually in 1960 (GX 33, p. 3-6671*; GX 662, pp. 3-6201-02*; Bergmann, R. 27; Tr. 2820*[6]). It is impossible for individual licensees

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[4] Sealy developed and required compliance with specifications for all Sealy products, and initiated a program for checking on the products manufactured by each licensee for conformity to such specifications (Fdgs. 37, 38, 41, 46, R. 75-77, 79).

[5] Shortly before the trial, Sealy's staff of professional, technical and clerical personnel numbered twenty-three persons (Fdg. 60, R. 84).

[6] Transcript pages on which exhibits cited herein were offered and received in evidence are listed in a table at the back of this brief. Where exhibits are cited that have not been printed in the record in this Court, the specific page number within the exhibit has been cited for convenience, and it has been marked with an asterisk (*). Similarly, where the trial transcript has been cited for testimony not printed, it is identified with an asterisk, *e.g.*, Tr. 100*.

to engage in national advertising owing to the local nature of their businesses and the fact that their sales would not support the expenditures necessary (Bergmann, R. 28; GX 662, p. 3-6202*; GX 1107, R. 1319-21). Sealy's national advertising includes special merchandising programs (Sealy's semi-annual promotions), which are supplemented by local advertising, sales portfolios, and dealers' aids. These promotional events are "vitally important" to Sealy licensees and account for approximately half of their annual sales volume (Fdg. 47, R. 80; Bergmann, R. 25-26, Tr. 2845-47*; see GX 618, p. 3-1944*).

Although substantially all of Sealy's stock for many years has been owned by its licensees, the evidence shows that Sealy has been operated as a separate entity, in its own interest, and not in the private interests of its licensees, as the Government suggests. The Sealy stock is owned in widely varying amounts by the stockholders and licensees and, with each share having one vote, Sealy has usually been subject to "control" by a group of only three or four stockholders (GX 981, R. 947; GX 985, R. 957; GX 991-H, R. 967-69). Contrary to the Government's assertion that no licensee owned more than 14% of Sealy stock (GB 7), one licensee and his family owned 25% (GX 985, R. 957; GX 991-H, R. 968).[7] This licensee—Brown, of Detroit—together with the Kansas City and Chicago licensee interests, owned about 49% of the outstanding stock; in combination with practically any other single stockholder, this group held voting control of the company (Fdg. 75, R. 87; GX 985, R. 957; GX 991-H, R. 967-69). Similarly, in earlier years, the Memphis licensee at times owned enough Sealy

[7] As in many closely held corporations, there have been limits upon the amount of stock one stockholder, or persons affiliated with him, could own—at various times 38% and 25% (Fdg. 69, R. 85; GX 981, R. 947-48).

stock to exercise voting control of the company if joined by only one or two other stockholders (Fdgs. 68, 72, R. 85-86).[8]

Sealy's by-laws provide that each director must be either a Sealy stockholder or the nominee of a stockholding licensee (GX 981, R. 948). There is no requirement in the modern Sealy contracts that licensees own stock in Sealy (see, *e.g.*, GX 1086, R. 1296-1314). Nor is there any restriction on the sale of Sealy stock only to licensees, although the stock carries preemptive rights and most of the stock is owned by licensees or persons having direct or indirect interests in licensee concerns (GX 981, R. 946-56; GX 1008, p. 3-5472*; Fdg. 74, R. 86; GX 1011, R. 990; GX 985, R. 957; GX 991-H, R. 967-69). Some stock is held by non-licensees, such as Earl Bergmann, Sealy's president in the 1950's (Fdg. 70, 73, R. 85-86).

The business of Sealy is "managed and controlled" by its board of directors; a quorum (eight) of the fourteen-member board can act with a majority (five); thus, five directors can make decisions for Sealy (GX 981, R. 948-50; GX 991-D, R. 958). Between its meetings, the executive committee of the board, composed of Sealy's president and five board members, acts by "vote of a majority of the whole Committee" (GX 981, R. 950).

When questions have arisen in Sealy concerning the interests of a particular licensee, *e.g.*, the termination of a license, the transfer of territory from one licensee to another, and the like, whether in the board of directors or executive committee, representatives (if any) of affected licensees were excused; "the licensees involved could not

[8] Sealy's stock was placed on a regular dividend basis in 1946 (Fdg. 67, R. 85); it has increased in value from about $30 per share in 1936 to $352 per share in 1956 (Fdgs. 66, 76, R. 84-85, 87).

participate in Sealy's decision" (Fdg. 30, R. 73; see also Fdg. 104, R. 97; Fdg. 113, R. 102; Fdg. 117, R. 103). This avoided potential conflicts of interest, and was consistent with Sealy's policy that its board of directors should consist of "capable, energetic, ambitious and sound thinking men, who have the interests of Sealy, Inc., at heart . . ." (Fdg. 45, R. 79).[9]

B. Origin and Development of Sealy

The "Sealy" trademark has been used on bedding since 1889, and at least from 1918 to 1923 it was used on mattresses manufactured by Sealy Mattress Company, a division of Sugar Land Industries (Fdg. 16-18, R. 67-68). It is undisputed that until the early 1920's "Sealy" products were manufactured solely by this company at its four factories in the midwest and southwest, and that in 1923 Sugar Land Industries began to sell its "Sealy" plants to local interests, licensing each purchaser to continue to manufacture and sell Sealy products (GB 3; Gov't Pre-Trial Brief 5, Oct. 15, 1963). Sugar Land Industries also licensed other bedding manufacturers in different parts of the country to manufacture and sell bedding under the Sealy trade name and trademarks and, by the end of 1923, some nineteen plants were operating under territorially restricted licenses from, and paying royalties to, Sugar Land Industries (Fdg. 18, R. 68; GB 3). The evidence shows that Sealy is the successor in interest to this licensor, and that little has changed in the arrangement over the years except that licensee interests own the bulk of its stock. Nothing about the arrangement bespeaks a conspiracy to restrain trade.

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[9] In a speech to a 1948 meeting of licensees, the president of Sealy pointed out that Sealy "had delegated most of the work to a few men who had spent much time working entirely in behalf of Sealy, Incorporated, even though it meant sacrificing the time from their own individual jobs" (GX 964, p. 3-1738*).

In 1923, Sugar Land Industries granted to one E. E. Edwards an option to purchase all of the intangible assets of Sealy Mattress Company, *i.e.*, "patents, trademarks, copyrights, trade names, and good will," and "all license contracts and royalties and rights thereunder" (Fdg. 18, R. 68; GX 2A, R. 186-88). Edwards and two associates worked out a plan for organization of a new corporation—in which they would own 25% of the stock—to acquire the intangible assets of Sealy Mattress Company and continue to license mattress manufacturers (Fdgs. 19-22, R. 68-69; GX 1, R. 161; GX 2A, R. 189-91). The remaining 75% of the stock was to be issued to the licensees (Fdg. 20, R. 69; GX 2A, R. 191). Sugar Land Industries was to receive promissory notes from the new corporation, secured by a pledge of its stock and assets (GX 2A, R. 185-86, 190, 196-97). In 1925, Sealy Corporation was organized and the plan was effectuated (Fdg. 22, R. 69-70; GX 2A, R. 166-98; GX 3, R. 199-200; GX 4, R. 202).

At the time Sealy Corporation was organized, the licensees were operating in territories assigned to them by Sugar Land Industries.[10] It is undisputed that, ever since,

[10] The Government's suggestion that in 1925 the licensees initiated a system of allocating exclusive territories for manufacturing Sealy products (GB 4) is unsupported by any evidence, and is contradicted by the specific finding of the district court that territorial licensing was engaged in by Sugar Land Industries in the early 1920's (Fdg. 27, R. 72), and by the following evidence: (1) organizational documents and minutes of the organizational meetings (GX 2A, R. 187, 193; GX 3, R. 200); (2) reference to a request by Sealy Corporation to an official of Sugar Land Industries to settle territory boundary questions (GX 11, p. 3-7135*); (3) reference in a listing of territories to an Iowa territory "as written and rates figured April 11, 1923," signed by Sealy Mattress Co. (GX 27, R. 238); and (4) references in the margin of the same listing to the dates "4-1-23" and "5-19-24" in connection with the Indianapolis and Memphis territories (GX 27, R. 235-36, p. 3-7253 (marginal notes unprinted)).

"Sealy" license contracts have authorized licensees to manufacture and sell "Sealy products"—manufactured according to Sealy specifications and sold with a Sealy label —only within prescribed territories, and that the licensors, from Sugar Land Industries to the present Sealy, have agreed not to manufacture, sell or license another to sell therein so long as the licensee continued satisfactorily to carry on the Sealy mattress business within the territory (Fdg. 27, R. 72; GX 27, R. 237; *e.g.*, GX 1012, R. 997, 998, 1000-01; GX 1086, R. 1296, 1297-98, 1301-03). It is also undisputed that "Sealy" licensees have never been restricted as to the areas in which they could manufacture and sell non-Sealy products (Fdg. 27, R. 72; GB 14 n.7).

Sealy Corporation paid a great deal of attention to the development of advertising and merchandising programs; it was recognized that the licensees could accomplish merchandising through the Sealy organization that "no one individual could do" (GX 1, pp. 3-7089-91*). In 1926, when Simmons began to advertise its "Beautyrest" mattress nationally, Sealy Corporation developed a competitive line and "began to advertise against the Simmons Company" (Bergmann, R. 25, Tr. 2831*). In 1927, the executive committee discussed national advertising of Sealy mattresses, and the record shows national radio broadcasting in 1928 (GX 5, p. 3-7053*; GX 6, p. 3-7167*).[11] In 1932, the suggestion was made to change the basis for royalties from sales to circulation of national publications in licensees' territories because, as a licensee stated, "the primary purpose of the organization is to secure national advertising, and that mainly is what each factory secures from the Sealy Corporation" (Fdg. 26, R. 71).

[11] In addition, direct mail advertising was sent out by Sealy Corporation, and it prepared advertising leaflets and phonograph records for salesmen (GX 3, p. 3-7019*; GX 4, R. 203).

Other subjects engaging the attention of Sealy Corporation and its licensees included joint purchasing (GX 1, pp. 3-7086-88*, R. 164; GX 3, R. 201), financing dealers, grading cotton, packaging, new products, production machinery, and hotel exhibitions (Fdgs. 24-26, R. 70-72).

Frequently considered were ways and means of recruiting additional licensees in territories unlicensed or not adequately covered. In 1925, the executive committee discussed the possible licensing of factories in Boston, Philadelphia, Seattle, Mexico, and Canada (GX 3, pp. 3-7020-21*). A Boston licensee was still being sought in 1928 (GX 6, R. 206), and, in 1931 and 1932, E. E. Edwards was seeking good prospects where distribution gaps existed (GX 17, R. 225; GX 18, R. 227). The district court found that such activity could not "reasonably be expected of an organization formed or operated to divide the country among a group of competitors" (Fdg. 31, R. 74).

In 1932, Sealy Corporation's executive committee proposed a corporate reorganization owing to its financial difficulties and those of its licensees, whose numbers had dwindled from twenty-six to eight who were still active (Fdgs. 26, 32, R. 71, 74; GX 4, p. 3-7128*). Agreement was reached on cancellation of existing license contracts and revision of assigned territories; the objective was to have Sealy factories in forty listed cities in the United States and seven in Mexico, Canada, and Cuba, because "it was unanimously conceded that the mattress business is very nearly a local business, and it is practically impossible for a foreign factory to go into a local territory and secure any profitable business" (Fdg. 26, R. 71; GX 7, p. 3-7213*). Executive committee members were assigned to various sections of the country to solicit new licensees (GX 7, R. 209).

The reduction of royalties due to the decline in number of licensees led in 1932 to default by Sealy Corporation on the notes issued for purchase of Sealy Mattress Company (Fdg. 32, R. 74). Promoter Edwards reorganized the trademark owner and licensor as Sealy, Incorporated, the appellee, which carried on business in much the same manner as Sealy Corporation (Fdgs. 32-36, R. 74-75).

The search for new licensees to cover all parts of the United States and thus fully exploit Sealy's trademarks, patents and processes has never ceased (Fdgs. 84-109; R. 89-101). When the executive committee met and approved reorganization in July 1933, it considered a proposal "to divide the entire United States between the present group" (Fdg. 86, R. 91; GX 8, R. 213). *This proposal was rejected,* and instead it was "unanimously agreed that a large number of new factories be brought into" Sealy,[12] in order to increase royalties and expand national advertising (*ibid.*).[13]

[12] As shown by the context, the rejection of this proposal amounted to a refusal by the licensees involved to assume responsibility for advertising and promoting Sealy in substantially larger territories than they then served.

[13] One later plan for recruiting licensees contemplated that an existing licensee would sub-license portions of his territory to other manufacturers, who would be responsible to the licensee and also would acquire Sealy stock from such licensee (GX 31-E, R. 272). At the same stockholders' meeting, in July 1935, at which this plan was adopted, the president was authorized to add virgin territory to the territory then assigned to each licensee, so that the population in his territory would be proportionate to his share of Sealy stock (GX 31-E, p. 3-7247*). Contrary to the implication at GB 4, *there is no indication that this was carried out,* and a year later, the sub-licensing plan was abandoned in favor of licensees' relinquishing unused territory to Sealy for assignment by Sealy to new licensees (Fdg. 89, R. 92-93; GX 33, R. 279-82). The principle became established—and was never again in question—"that 'the franchising of territories is an exclusive right that is the property of Sealy, Incorporated,'

The revised 1936 license contract in effect required each licensee to reduce his licensed territory to his "natural, or normal, trading area" by releasing unworked territory for relicense by Sealy to other manufacturers (*e.g.*, GX 1012, R. 997, 1001, 1009; GX 33, R. 280-81).[14] By the terms of his contract a licensee could only retain that territory in which he satisfied "the market and demand" for Sealy products, and in which he used his "best efforts to enhance the popularity and demand" for Sealy products (*e.g.*, GX 1012, R. 998). In 1937, Sealy established minimum royalties based upon objective standards for measuring a licensee's efforts (and his right to retain his territory); sales quotas were based upon "proper trading areas" and upon "buying power per family or per capita within each territory" (Fdg. 91, R. 93; GX 35, R. 294; see GX 932, R. 910).

As early as 1936, licensees voluntarily released territory to Sealy for reassignment to new licensees, and in 1938, after minimum royalties were established, as noted above, additional amounts of territory were ceded to, and again became the property of, Sealy (Fdgs. 89, 92, R. 92-94; GX 33, R. 281-82; GX 40, R. 301).[15] Procuring the release of

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and a licensee could not relicense territory to another plant" (Fdg. 87, R. 92; GX 234, R. 509).

[14] This contract reaffirmed the contractual right of a licensee to exclusive use of the Sealy name and good will in his assigned territory and provided for liquidated damages, payable by Sealy, for infringement of that right by Sealy or another licensee (*e.g.*, GX 1012, R. 1001-02). The same $10 liquidated damages provision was still in a 1956 Sealy contract, but there is only evidence that it was enforced once in that twenty-year period, when a licensee was paid $140 for shipment of fourteen mattresses into his territory (*e.g.*, GX 1094, pp. 3-331, 3-336, 3-345*; GX 492, R. 837).

[15] At the peril of cancellation of his license for failure to comply, modern Sealy contracts require each licensee to pay royalties to Sealy, the amount of which is determined by applying a declining percentage

territory not properly exploited and seeking new licensees were constant activities by Sealy, and the Government's implications that licensees jealously held areas they could not adequately exploit (GB 20 n.12, 25 n.16) are contrary to the preponderance of evidence and the district court's findings (Fdgs. 84-118, R. 89-104).[16]

The court cited as an excellent example of Sealy's efforts to broaden its distribution the evidence relating to the southeastern part of the United States, in which Sealy "obtained territory from old licensees, found new licensees, shifted territory among licensees, discontinued its contracts with some licensees, and finally found a satisfactory licensee for the Carolinas at Lexington, N. C., but never did, insofar as the record shows, settle on a suitable licensee for Georgia and Florida" (Fdg. 85, R. 91). Similarly, it was not until 1951 that Sealy found a licensee for the greater Philadelphia area—a firm which had no previous experience in the mattress manufacturing business (Fdg. 104, R. 97; Bergmann, R. 27). The district court found that, from 1933 "forward,

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(*e.g.*, 3% for first $1 million sales) to the licensee's sales or "sales par" within his territory, whichever is greater (*e.g.*, GX 1086, R. 1307). Sales par refers to the licensee's sales quota, and is determined by use of a United States Survey of Buying Potential Power for each county in the United States (GX 994*, GX 995*; see Fdgs. 82, 91, R. 88-89, 93).

[16] The Government relies upon a single, colorful statement made by Sealy's president when a licensee refused voluntarily to agree to modification of his contract, and upon reports indicating that Sealy's coverage of every county in the United States never attained a state of perfection (GB 20 n.12, 25 n.16). Any inference from these bits of evidence is rebutted by the numerous instances in which Sealy was successful in procuring the release of unused territory for reassignment; the contracts that were cancelled because of inadequate sales effort; and the fact that while Sealy was constantly striving to obtain the greatest coverage possible, licensees had contract rights which Sealy could not arbitrarily set aside.

and up to the latest times covered by plaintiff's evidence, the record shows that Sealy continued to seek new licensees to fill in parts of the country not adequately served by existing licensees. It is obvious that an essential inducement to prospective licensees—to get them to undertake the obligations of a Sealy license—was the grant of exclusive rights in the territories in which Sealy asked them to manufacture, distribute, and pay royalties" (Fdg. 86, R. 91-92).

Whenever there were disputes over the boundaries of licensees' territories, Sealy would resolve them in the best interest of Sealy, although frequently requesting the disputants to try to compromise and propose a settlement to Sealy.[17] The Government has quoted at length an example of Sealy's handling of a dispute—over territorial rights to Arizona—but has told only part of the story (GB 5 n.2). *The dispute arose because Sealy had inadvertently included Arizona in both the Southern California and Denver licenses* (GX 169, R. 421-22). The Southern California licensee wrote to the Denver licensee and objected to the latter's selling into Arizona after having recognized the former's rights there for a number of years; he complained:

"Our many years of effort in developing Arizona for Sealy seems now in jeopardy because of an unauthorized sales organization creating confusion and doubt in the minds of the Arizona dealers" (GX 164, R. 410-11).

The Denver licensee stood on its contract rights, insisting that "we do own the Arizona territory" (GX 165, R. 412-13). Whereupon, the California licensee, as noted by the Government (GB 6 n.2), placed the matter in Sealy's hands. The president of Sealy sought an amicable settlement, but did not count himself out, as the Government's excerpt sug-

[17] See Fdg. 30, R. 73-74, re Sealy Corporation's handling of disputes.

gests; after asking each licensee to review its history of servicing Arizona, he said:

> "With this information at hand, *I believe that the three people, namely the two Sealy licensees and the arbitrator, who can be either the president or legal counsel of Sealy,* should be able to come quickly to some amiable handling" (GX 167-A, R. 418, emphasis added).[18]

Ultimately, the State of Arizona was divided by Sealy on the basis of "practical service arrangements" (GX 167A-175, R. 417-30; GX 176, R. 431-32).

From time to time Sealy terminated the contracts of licensees for poor performance. For example, after a new Charlotte, North Carolina, licensee underwent a change in ownership, Sealy's board of directors voted to continue the license contract (Fdg. 116, R. 103; GX 624, p. 3-1852*; GX 625, p. 3-1853*), but two years later the board refused to renew it because the "manufacturing and sales facilities" of the licensee were "deemed inadequate" and "insufficient to meet the requirements of Sealy, Incorporated in the territory covered by the license" (Fdg. 117, R. 103; GX 632, pp. 3-1585-86*). A license contract for Kansas City was terminated because the licensee was not making a "satisfactory showing" for Sealy (Fdg. 114, R. 102). Not all of the turnover in Sealy licensees was due to termination by Sealy, however; the district court enumerated examples of contracts that were terminated at the request of licensees who withdrew because they wanted to be relieved of their contract obligations (Fdgs. 110-12, R. 101-02; Fdg. 115, R. 102-03).

On the record as a whole, the district court found that the evidence "negatives the existence in the origin of Sealy

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[18] It should be noted that the 1936 license contract provided for arbitration of any dispute between the parties (*e.g.*, GX 1017, R.1103-04). Only Sealy had the power to approve changes in assigned territories (*e.g.*, GX 1017, R. 1095, 1097; Fdg. 87, R. 92).

Corporation of a central conspiratorial purpose to divide the United States among competing mattress manufacturers" (Fdg. 25, R. 71; see also Fdgs. 24, 26, 31, R. 70-72, 74). It further found that Sealy Corporation's "entirely legitimate business purposes . . . were carried out by successor companies, including defendant, whose activities have been directed not toward market division among licensees but toward obtaining additional licensees and more intensive sales coverage" (Fdg. 119, R. 104).

C. The Bedding Industry

Owing to the hard-core conspiracy theory upon which the Government proceeded from the outset of this case,[19] the record contains little information concerning the bedding industry or the economic consequences of Sealy's contracts. During discovery, the Government filed extensive briefs in support of a motion by Simmons Company to quash portions of Sealy's subpoena calling for data on its operations, asserting that the Complaint charged per se violations of the Sherman Act which rendered completely irrelevant the subpoenaed material tending to confirm the reasonableness of defendant's conduct.[20] The district court granted the

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[19] See note 2, *supra* and accompanying text. In Answers to Defendant's Interrogatories Served October 11, 1960 (p. 1-336) the Government charged that "the original member factories organized" Sealy "and used the corporation as an instrumentality to allocate exclusive marketing territory."

[20] See United States v. Serta Associates, Inc., 29 F.R.D. 136, 138 (N.D. Ill. 1961) (setting forth a brief opinion on an identical subpoena served by Serta upon Simmons; the Government's companion case against Serta is described in note 1, *supra*). The Government charged Sealy and its licensees with "collusive activities" to allocate territories, and argued that it was trying to "inveigle the Court to permit [it] to conduct an industry-wide inquiry so that [it] might demonstrate the reasonableness of [its] conspiratorial market division scheme." Plaintiff's Brief in Opposition to Defendants' Briefs Opposing Motions of Simmons to Quash, pp. 22, 60, Oct. 12, 1961.

motion to quash (unprinted order dated Dec. 15, 1961) and Sealy abandoned this line of discovery. The Government's position at trial was similar—objections to industry data were made on the ground that it was "totally irrelevant to the issues involved in this case" (see, *e.g.*, R. 24).[21] Nevertheless, certain basic industry information—received as "background" (*ibid.*)— appears in the record, and certain other information is available from reliable sources.

Between 400 and 500 companies belong to the bedding manufacturers association (Bergmann, R. 24), and Government counsel, specifically conceding that Sealy licensees "have many business competitors in the mattress industry," disclaimed any contention of a lack of vigor in interbrand competition (R. 33).[22] Such competition in the bedding industry was described by a district sales manager for Simmons Company as "very tough, very competitive," "vigorous," and "strong" (Hutchinson deposition, R. 33; see also Tr. 3062-63*). Competition among retailers also is vigorous, with literally hundreds of outlets—such as furniture and department stores and mail order houses—handling various brands of bedding in metropolitan areas (Goldstein deposition, Tr. 3140-41*; Graff and Pelts depositions, R. 38-40).

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[21] Government counsel also stated (R. 10-11): "The defendant, Your Honor, would like to make this a complex matter. There is, however, Your Honor, only one conspiracy consisting of two charges or terms of the conspiracy in this case. The first is that the defendant conspired to fix prices, and the second is that the defendant was engaged in a conspiracy to divide territories. Thus, there are two sets of facts, the existence or nonexistence of which are all that need be ascertained." He further stated (R. 12): "I am not interested in whether or not what . . . [Sealy] had done is reasonable. That is not at issue in this case."

[22] Government counsel also stated: "Simmons has got plenty of competition. Englander is there. There are many small local mattress industries competing" (R. 12).

National advertising and merchandising have become increasingly important in the bedding industry over the years since Simmons introduced and began advertising its "Beautyrest" mattress in about 1926 (Bergmann, R. 25-27; Hutchinson deposition, R. 29-30, 34-36; Musicus deposition, R. 36-38). Promotions like Sealy's semi-annual sales are an industry-wide practice and generate a substantial portion of bedding sales (Bergmann, R. 25-26, Tr. 2855*; Hutchinson deposition, R. 30; see also Tr. 3019-20, 3025-29*). In a brief the Government noted that, in addition to Simmons, "Englander, Stearn-Foster, Burton Dixie, Restonic and other mattress manufacturers and groups" engage in national advertising.[23]

Simmons, "far and away the leader in its industry" and the first company in its industry "to establish a consumer franchise through advertising," had 1959 worldwide sales of $133 million.[24] It operates out of fourteen plants and sixty-five warehouses throughout the country.[25] Englander, at the time of trial, was a privately held corporation, sales

[23] Government's Post Trial Reply Brief, p. 12, July 2, 1964.

[24] Address by Grant Simmons, Jr., National Society of Security Analysts, Sept. 11, 1964; MOODY'S INDUSTRIAL MANUAL 972 (June 1966). In a recent trademark infringement action brought by Simmons Company, a district court found that Simmons:

> "has spent great sums in advertising its products and in establishing the name SIMMONS in the mind of the public. In the last twenty years, it has spent an average of two million dollars per year for advertising. Most of this expenditure was for advertising in magazines of national circulation, and in all such advertisements, the Plaintiff's name 'Simmons' was prominently displayed." Simmons Co. v. Baker, 200 F.Supp. 149, 151 (D. Mass 1961), *aff'd*, 307 F.2d 458 (1st Cir. 1962), 342 F.2d 991 (1st Cir.), *cert. denied*, 382 U.S. 820 (1965).

[25] Address by Grant Simmons, Jr., *supra* note 24.

of which are unavailable; in 1964 it was acquired by Union Carbide Corp., which had total 1959 sales of $1.5 billion (MOODY'S INDUSTRIAL MANUAL 2218-19 (June 1966)).

The president of Simmons has said that Simmons' "principal competitors are looseknit packs of local manufacturers who have banded together under group names to fight us."[28]

SUMMARY OF ARGUMENT

Having lost this case in the district court on a hard-core conspiracy theory, the Government now shifts its ground and argues that the Sealy arrangement is a joint venture which "closely resembles . . . classic division-of-territories" (*Cartel*) cases, and is per se unlawful—solely because of the restrictive territorial provision in the Sealy licenses and the ownership of the bulk of Sealy's stock by licensee interests. The Government does not directly attack the findings by the district court that the purpose of Sealy and its licensees was in no respect collusive or anticompetitive, but it does so indirectly. It points the fingers of "doubt," "distrust," and "skepticism," and asserts the unlikelihood that the "decisive motivation" for the arrangement is legitimate, relying upon such insinuations to take the place of evidence of unlawful purpose. Moreover, in place of record evidence as to the actual competitive effects (if any) of Sealy's territorial restrictions, the Government relies upon economic arguments and a fallacious analogy to price fixing. Upon the basis of such theorizing, the Government would have the Court find a "probability" of economic harm and "too remote" a possibility of justification to necessitate a trial on the effects issue.

Trial anew in this Court of the issue of conspiratorial purpose, which the Government in effect seeks, would contravene the rule of *United States* v. *Yellow Cab Co.*, 338

[28] Address by Grant Simmons, Jr., *supra* note 2.

U.S. 338 (1949). But, aside from this, the judgment of the district court upholding Sealy's arrangement is fully supported by the evidence and the applicable law.

The present case bears no resemblance to the *Cartel* cases both because the fundamental purpose of the Sealy arrangement is entirely legitimate and because Sealy and its licensees concededly "compose but a small segment of the bedding industry." The suggestion that Sealy's arrangement amounts to a market sharing scheme is refuted by its continued quest for new licensees, both as replacements and to expand Sealy's distribution coverage, and by Sealy's separate existence as a profitable enterprise operated for its overall best interests, and not as a mere instrumentality or creature of its licensees.

Well established as part of the rule of reason governing application of the Sherman Act, the doctrine of ancillary restraints permits reasonable partial restrictions which are ancillary to the primary purpose of a lawful business arrangement. It serves the important function of permitting flexible adaptation of the Sherman Act to many commercial transactions where restraint of competition is plainly not the object of the parties and where the public interest is not jeopardized. Sealy's territorial provision comes squarely within this doctrine: It is ancillary to a lawful main purpose —the licensing of Sealy's trademarks, know-how and advertising-merchandising services, in exchange for royalties. The Government's arguments, seeking application of a per se rule in the face of the findings of fact making the ancillary restraints doctrine clearly applicable in this case, reflect an attempt to circumvent the principle of reasonableness upon which the doctrine focuses and, if accepted, would place the whole concept in jeopardy.

The territorial restriction of Sealy's licenses is necessary, reasonable, and in the public interest. Territorial protection

is necessary to induce small manufacturers to invest the required capital and effort to develop "Sealy" business in each territory. It is also well-adapted to the preservation of the validity of Sealy's trademarks as against the risk of confusion of the public through use of the mark by different manufacturers in the same markets. The territorial protection is reasonable owing to its limitation to "Sealy" products; Sealy licensees are free to manufacture and sell their own-brand products without restriction, and concededly do so, and since the licensees would not accept license obligations without territorial protection, no competition by one firm with another which might exist absent the licenses is eliminated. It is in the public interest because the Sealy name and supporting services furnished by Sealy provide the licensees with the means to produce uniform, quality goods and to compete effectively with large, integrated bedding competitors.

The Government's arguments here, analogizing the instant case to *Cartel* and price fixing cases, are almost identical to its arguments in *White Motor Co.* v. *United States*, 372 U.S. 253 (1963), and here, as there, they are completely without foundation. The Government also urges here, as in *White Motor*, adoption of a per se rule of illegality outlawing the arrangement challenged, with no evidence of its actual effect in the marketplace. Thus, the Government's contentions amount to an effort to relitigate *White Motor*, and they should be rejected.

The Government's economic arguments liken Sealy's manufacturing licensees to retail dealers in manufactured products, and its supporting legal arguments are rooted in cases outlawing unreasonable restraints upon alienation of commodities. But Sealy licensees are not dealers; rather, they have the same problems as other manufacturers who must establish and maintain distribution through a dealer or-

ganization, *e.g.*, giving the dealer something of a "franchise," and furnishing advertising and promotional support. Integrated manufacturers concededly have the right to select their dealers and limit the number appointed in a given market (a highly important consideration to dealers), and Sealy's licensee manufacturers must be permitted this right in order to be competitive. Otherwise, their dealer organizations would be jeopardized and, because neighboring licensees would be free to "skim off the cream," licensees naturally would reduce their efforts and expenditures in promoting the Sealy brand, and the brand ultimately would disappear.

The Government has established no reason whatsoever why a rule of per se illegality should be created and applied to territorial restrictions such as those here. Such a rule, with the harsh consequences noted above, would be stricter than would be applied to a Sealy-licensee joint venture under Section 7 of the Clayton Act, or to a merger of Sealy and the licensees, or even to a "tying" arrangement. Present law can reach market sharing conspiracies and arrangements which in fact unreasonably restrain trade; the rule urged by the Government would *also* outlaw an untold number of "franchise" arrangements, having no unlawful purpose or effect, to the serious detriment of numerous small businessmen.

A great many franchise programs involve territorial restrictions and adoption of a per se rule here would jeopardize inter-brand competition, in other industries as well as in bedding. Both the Small Business Administration and the Federal Trade Commission advocate a "rule of reason" rather than a per se approach to vertical territorial restrictions but, if the Government's "control" arguments here should be accepted, there would remain little basis for a distinction between vertical and horizontal

arrangements (a result which the Government sought in *White Motor*). Such a result would drastically affect the burgeoning "franchise" movement in a great number of fields—including the highly important programs in the wholesale and retail food industries—thereby contravening the national policy to foster small business. Only a rule of reason approach to such franchise agreements will permit the kind of case-by-case examination that will protect necessary and reasonable arrangements like Sealy's, while enabling the Government to attack such systems when they have an anticompetitive purpose or effect.

As a matter of justice and fairness, since the Government deliberately chose to keep out of the record evidence concerning the actual effect of Sealy's licenses, it should not now be heard to argue what the presumed effects would be, nor should the case be remanded to give the Government a chance to search for possible anticompetitive effects evidence which it obviously did not have at the time of the first trial. This is particularly true since this is the second time Sealy's territorial restrictions have been called in question under the antitrust laws. The Federal Trade Commission in 1944 issued, and thereafter tried, a complaint substantially like that here and, in 1948, it found no violation. No change in circumstances having been shown, further proceedings against Sealy would amount to harassment.

ARGUMENT

I.

The Trial Court's Judgment Is Fully Supported by the Facts and the Applicable Law

A. The Government Has Failed to Prove "Hard-Core" Conspiracy

The Government tried this case as one involving a hard-core conspiracy specifically designed to eliminate competition in violation of the Sherman Act. It contended that the Sealy licensees were competitors who effected a division of territories among themselves for the sale of Sealy products, utilizing a licensing corporation that was nothing more than a creature of its licensees—a mere "cover" for a horizontal conspiracy of the kind held illegal per se in cases such as *Addyston Pipe & Steel Co.* v. *United States,* 175 U.S. 211 (1899); *United States* v. *National Lead Co.,* 332 U.S. 319, 343 (1947); and *Timken Roller Bearing Co.* v. *United States,* 341 U.S. 593 (1951).

Although a per se rule was followed in these classic *Cartel* cases, it was applied after careful consideration of the nature and purpose of the arrangement attacked, and after a determination that market division was a primary objective, and not merely incidental to a legitimate main undertaking.[27] Not only did the challenged arrange-

[27] In *Addyston Pipe,* the sole purpose and effect of an agreement among dominant manufacturers was to fix prices and divide territories; in the territory covered by the combination (over three-fourths of the United States) the parties controlled two-thirds of the industry output and had, and exercised, the power to fix prices. 175 U.S. at 235-36. In *National Lead,* it was found that the paramount purpose and the effect of the arrangements under attack were division of markets and suppression of competition for virtually all of the world's supply of titanium. 63 F.Supp. at 522-24. In *Timken,*

ments in these cases reveal "no purpose other than the elimination of competition", but they were found in cases where "all . . . competitors . . . as a group possessed substantial, and often dominant, market power."[28] This is not such a case.

Although the Government adduced reams of documents concerning the affairs of Sealy and its predecessors—from 1920 until 1960—the district court held that it failed to prove:

> "by a preponderance of evidence that defendant, Sealy, Incorporated, has engaged in a combination and conspiracy with its manufacturing licensees to allocate territory among competitors in unreasonable restraint of trade in violation of Section 1 of the Sherman Act, 15 U.S.C. §1" (Conclusion 3, R. 151).

This conclusion was founded upon 105 separate findings of fact, which in turn were based upon hundreds of exhibits, which were read, "cross-examined,"[29] and commented upon in open court. The trial court's ultimate finding on the

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the district court had found "that the 'trade mark provisions [in the agreements] were subsidiary and secondary to the central purpose of allocating trade territories'." They were *not* "merely incidental to an otherwise legitimate 'joint venture'," *nor* "reasonable steps taken to implement a valid trademark licensing system," but rather applied to 80% of all tapered bearings manufactured in the United States, Britain and France, and involved "an aggregation of trade restraints"; the restrictive agreements "went far beyond protection of the name 'Timken' and provided for control of the manufacture and sale of antifriction bearings *whether carrying the mark or not.*" 341 U.S. at 598-99, emphasis added.

[28] Att'y Gen. Nat'l Comm. Antitrust Rep. 26 (1955).

[29] When Government counsel finished reading portions of an exhibit, the trial court permitted defense counsel to "cross-examine" by reading other portions.

territorial issue was that the Government's evidence, "read as a whole, conclusively prove[d] that the Sealy license arrangements were developed . . . for entirely legitimate business purposes" and that Sealy's activities had "been directed not toward market division . . . but toward obtaining additional licensees and more intensive sales coverage" (Fdg. 119, R. 104).

The Government makes no direct attack upon any of the district court's findings—either as to the legitimate business purpose of the Sealy licenses or the independence of Sealy and the constructive nature of its activities. It does indirectly attack those findings, however, by asking the Court to infer improper purpose and to disregard the evidence of Sealy's independence. Thus, the Government actually urges this Court to "try the case de novo on the record," particularly as to the intent of the parties over a great stretch of years, directly contrary to the rule of *United States* v. *Yellow Cab Co.*, 338 U.S. 338, 340 (1949).

The Government asserts that "one is entitled to view with considerable skepticism a claim that the purpose of the restraint is not to . . . reap greater than competitive profits but to enhance inter-brand competition" (GB 11). It further speculates that legitimate reasons for Sealy's restrictions "are so unlikely to be the real . . . reasons that they may be disregarded" (GB 23); it suggests "doubt that [legitimate reasons] . . . constituted the real motive for the restriction" (GB 24); and it concludes from the totality of the suspicions it raises by its own speculations that "there is every reason to believe that these territorial restrictions were designed solely or primarily to allow the Sealy manufacturers to escape competition" (GB 25).

Sealy has never contended that it is in business for the purpose of enhancing inter-brand competition, and there is

no evidence that it or its licensees have reaped "greater than competitive profits."[30] What Sealy does contend is that competitive strengthening of Sealy licensees for legitimate business purposes at the same time has the *effect* of enhancing inter-brand competition.[31]

In any event, the inference of anticompetitive purpose which the Government would have the Court draw is refuted by the fact that the number of Sealy licensees in the 1930's was down to eight, but by the time of trial they numbered thirty (Fdg. 32, R. 74; GX 1107, R. 1319).

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[30] Carrying its speculation a step further, the Government hypothesizes that licensees' "monopoly profits" rather than any legitimate reason "constituted the real motive for the restriction" and, based on no evidence whatsoever, it suggests that a 3% royalty rate to Sealy is unduly low (GB 24).

[31] Although the Government conceded at trial that there is "plenty of competition" in the bedding industry (note 22, *supra*), and kept out of the record evidence as to the actual effect of Sealy's licenses, it argues on the basis of hypothesis and presumption that they in fact unreasonably restrain trade. In a classic example of bootstrapping, the Government reaches the conclusion that Sealy's territory restrictions are "very much like a price-fixing agreement" (GB 15). The Government first "presupposes" that the Sealy brand is somewhat insulated from competition (GB 11); it also says one "cannot assume" that Sealy's advertising has failed to create a unique demand sufficient to provide Sealy licensees with a certain freedom in pricing when protected from intra-brand competition. However, the territory restriction would be "futile," the Government asserts, if inter-brand competition were effective; but since the licensees insist upon the restriction, this "presupposes" that it in fact reduces competitive pressures—ergo, the arrangement is like price fixing (GB 14-15). This illogical speculation typifies the Government's arguments in this case; it ignores the facts that inter-brand competition is vigorous; that Sealy licensees need the Sealy arrangement precisely because of this powerful competition (see note 57, *infra*); and that such competition governs pricing in the marketplace of all bedding products, including "Sealy."

Why, if the Sealy arrangement was designed to eliminate competition by dividing the market, were all these new licensees recruited?[32] The answer is that Sealy does not "give" licensees their territories, nor do the licensees carve them up among themselves as private domains. Sealy "sells" the use of its name and services in specified areas, and the licensees pay therefor in royalties computed on the basis of consumer buying power, which is used to measure the value of the Sealy name and services in each area (see pp. 13-14, *supra*). This is a business arrangement, serving the legitimate interests of Sealy and its licensees, and in no sense a scheme to restrain trade.

Entirely because of the licensees' stock ownership of Sealy, the Government urges the Court to ignore the separate, profitable, and independent existence of Sealy, and the useful services it performs, and infer it to be an unlawful joint venture, amounting to a conspiracy. It abandons its trial theory and the record facts and asserts that, "*while we do not argue that Sealy, Inc. was no more than a facade for a conspiracy* . . .", owing to the licensees' stock ownership in Sealy "there is no escaping the conclusion that . . .—unlike a true 'vertical' restraint—competition has *in effect* been eliminated by the action of the competitors themselves. Thus the case *closely resembles* the classic division-of-territories agreement" condemned by the *Cartel* cases (GB 12, emphasis added).[33]

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[32] Specifically, why in 1951, with licensees as nearby as Reading, Pennsylvania, and Richmond, Virginia, did Sealy have to recruit a furniture manufacturer, teach him to manufacture bedding, and license him for the Philadelphia area, and license still another firm in the Baltimore-Washington area (see Bergmann, R. 27; Fdgs. 103-05, R. 97-99)?

[33] The Sealy-brand share of the mattress business is a far cry from "cartel" proportions; the Government itself recognizes that "in the

But, even under the antitrust laws—whose thrust may not be *evaded* by the device of a jointly owned corporation[34]—the separateness from its stockholders of a corporate entity will not be ignored without solid evidence that it is a mere instrumentality or creature of its stockholders, with no separate existence of its own; mere "control" by the stockholders is not enough to "pierce the corporate veil."[35]

Here, there is no evidence that Sealy is a mere creature or instrumentality of its stockholders. The record is clear that from the very first, when promoter Edwards organized Sealy Corporation with himself and various licensees as stockholders, and some of the same persons as directors, both the stockholders and directors wore a "Sealy hat" when they were acting on behalf of Sealy. This has not changed over the years. For example, although the Kansas City licensee clearly has an interest, qua licensee, in his own territory—Kansas and a portion of Missouri (see GX

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aggregate [Sealy sales] compose but a small segment of the bedding industry" (GB 15). According to Professor Machlup, a cartel will "go to pieces if 30 or 40 percent of the market . . . [is] served by outsiders"—if the cartel consists of less than 60-70 percent of the market. MACHLUP, THE ECONOMICS OF SELLERS' COMPETITION 532 (1952).

[34] See United States v. New Wrinkle, Inc., 342 U.S. 371, 374 (1952); United States v. American Tobacco Co., 221 U.S. 106, 171-72 (1911).

[35] See Union Pac. Coal Co. v. United States, 173 Fed. 737, 739 (8th Cir. 1909); Central Retailer-Owned Grocers, Inc. v. FTC, 319 F.2d 410 (7th Cir. 1963) (receipt of discounts by corporation wholly owned by a group of retailer owned wholesale grocers held not to amount to illegal payments in lieu of brokerage in violation of Robinson-Patman Act); Nuarc Co. v. FTC, 316 F.2d 576 (7th Cir. 1963) (common ownership of two corporations by the same individual held insufficient basis for holding a payment to one to be a payment to the other in violation of Robinson-Patman Act).

1064, R. 1213-14)——he has a national interest in the welfare of Sealy, both as a stockholder and as a recipient from its professional staff of technical and advertising and sales promotion services. Whereas he might have an occasional "border disagreement" with the St. Louis or Denver licensees, he has no interest as a licensee in territorial questions involving some twenty-seven other licensees located in other areas—most of them far from his own natural trade territory (see p. 13, *supra*). Thus, stockholder-licensees, as directors of Sealy, have been motivated to act—and in fact have acted—in the best interests of Sealy, Inc. Moreover, if the occasion arose when a licensee's interest was involved, he was not permitted to participate as a director or executive committee member in Sealy's discussion or decision on the matter (see pp. 7-8, *supra*). On this basis the interest of Sealy has been served—at the expense of individual licensees where that has been necessary.

The entirely legitimate origin of Sealy, the constructive services it performs, and its unceasing efforts to recruit new licensees, improve its distribution, and expand its royalty income, as shown by the record, foreclose any inference of anticompetitive purpose in the Sealy arrangement. The evidence showing the scrupulously maintained separation between Sealy's corporate interests and the individual interests of its licensees precludes the conclusion that Sealy and its licensees are not separate entities but comprise an unlawful joint venture.

In the final analysis, the Government tried and failed to prove hard-core conspiracy. Insinuation, inference and innuendo cannot be permitted to supersede

> "the considered judgment of an able trial judge, after patient hearing, that the Government's evidence fell short of its allegations—a not uncommon form of litigation casualty, from which the Government is no more

immune than others." *United States* v. *Yellow Cab Co.*, 338 U.S. 338, 341 (1949).

B. The Government's Evidence Shows That Sealy's Territorial Restrictions Are Ancillary to a Legitimate Primary Purpose and Do Not Unreasonably Restrain Trade

The territorial provision of the Sealy licenses does not constitute an unreasonable restraint of trade; the judgment of the trial court so holding is fully supported by the rule of reason and the venerable doctrine of ancillary restraints.

Judge Taft, later Chief Justice, reviewed the history of ancillary covenants at common law in *United States* v. *Addyston Pipe & Steel Co.*, 85 Fed. 271, 278-83 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899). He noted that the English courts long ago found it to be in the public interest to enforce certain covenants in restraint of trade, so that, for example, "after a man had built up a business with an extensive good will, he should be able to sell his business and good will to the best advantage, and . . . bind himself by an enforceable contract not to engage in the same business. . . ." (*Id.* at 280).[36] In what has become a classic statement of the ancillary restraints rule, Judge Taft pointed out that a covenant in partial restraint of trade is lawful if it

> "is merely ancillary to the main purpose of a lawful contract, and necessary to protect the covenantee in the enjoyment of the legitimate fruits of the contract, or to protect him from the dangers of an unjust use of those fruits by the other party." (*Id.* at 282).

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[36] One of the early cases discussed by Judge Taft was Mitchel v. Reynolds, 1 P.Wms. 181, 24 Eng. Rep. 347 (K.B. 1711), which upheld an agreement by a baker not to compete for five years with the person to whom he sold his bakery. The *Mitchel* case was considered in Standard Oil Co. v. United States, 221 U.S. 1, 54, 60 (1911), as part of the body of common law establishing "the standard of reason" for interpretation and application of the Sherman Act.

The English common law was carried into the law of this country, as shown in *Oregon Steam Navigation Co.* v. *Winsor,* 87 U.S. 64, 66-67 (1873). The Court sustained a partial restraint upon the purchaser of a steamship not to use the ship in an area where it would compete with the seller's business. The Court found the covenant not unreasonable and not larger than required to protect the seller. Similarly, *Fowle* v. *Park,* 131 U.S. 88 (1889), held valid and enforceable agreements perpetually restricting the territories in which the purchasers of a secret receipe and name for a patent medicine could manufacture and sell that product. Noting that the public welfare as well as private interests were to be considered, the Court stated:

> "The question is whether, under the particular circumstances of the case, and the nature of the particular contract involved in it, the contract is, or is not, unreasonable." (*Id.* at 97, citing the *Oregon Steam Navigation* case, *supra,* among others).[37]

In the multitude of cases in which restrictive covenants have been upheld under common law rules (where no question was raised under the Sherman Act), reasonableness has remained the touchstone for judging the validity of ancillary restraints. This standard has included reasonableness as to time, including restrictions unlimited in time;[38] reasonableness as to territory;[39] and reasonableness in both

[37] *Cf.* Apollinaris Co. v. Scherer, 27 Fed. 18 (S.D.N.Y. 1886), in which the court upheld the grant by a supplier in Hungary to a British company of the sole right to sell a product in Great Britain and America under the supplier's trademark.

[38] See cases collected in Annot., 41 A.L.R.2d 15, 41 (1955); Annot., 45 A.L.R.2d 77, 105 (1956).

[39] See cases collected in Annot., 43 A.L.R.2d 94 (1955); Annot., 46 A.L.R.2d 119 (1956).

of these aspects with respect to the general public.[40] 6A CORBIN, CONTRACTS §§1383-1394 (1962); 5 WILLISTON, CONTRACTS §§1636-1643 (rev. ed. Williston & Thompson 1937); see RESTATEMENT, CONTRACTS §§515, 516 (1932).

Under the Sherman Act as well as at common law, the courts have uniformly upheld reasonable restraints of trade where they were ancillary to a lawful main purpose of an agreement.[41] One of the early cases involved a covenant on the part of the seller of several ships to refrain from operating freight or passenger service between certain points served by the buyer. *Cincinnati, P., B.S. & P. Packet Co.* v. *Bay,* 200 U.S. 179 (1906). The Court found no violation of the Sherman Act, noting that interference with interstate commerce was not the "dominant purpose" of the contract, but that it was "made as part of the sale of a business and not as a device to control commerce." *Id.* at 184-85.[42]

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[40] See cases collected in Annot., 41 A.L.R.2d 15, 148 (1955); Annot., 43 A.L.R.2d 94, 227 (1955); Annot., 45 A.L.R.2d 77, 182 (1956); Annot., 46 A.L.R.2d 119, 263 (1956).

[41] In the *Addyston Pipe* case, *supra,* the Sherman Act was found to be violated because the restraints on competition engaged in by a combination of competitors were held to be the main *purpose* of the combination, not incidental to it; moreover, the facts demonstrated an adverse *effect* on competition. 85 Fed. 271, at 290-94; 175 U.S. 211, at 235, 238, 244.

[42] In Tri-Continental Fin'l Corp. v. Tropical Marine Enterprises, Inc., 265 F.2d 619 (5th Cir. 1959), a similar covenant was held an ancillary restriction, and "in every respect important here, reasonable in time, territory and extent, and of no further extent than is necessary to protect [the seller of the ship]; and that the authorities are almost uniform that such a restriction does not violate the anti-trust laws." *Id.* at 625. See generally, Bork, *Ancillary Restraints and the Sherman Act,* 15 A.B.A. ANTITRUST SECTION 211 (1959).

A territorially limited franchise system very like that adopted by Sealy's predecessor, Sugar Land Industries, was upheld in *Coca-Cola Bottling Co.* v. *Coca-Cola Co.*, 269 Fed. 796, 813-14 (D.Del. 1920). The developer of the formula for Coca-Cola syrup granted another concern exclusive rights to manufacture and sell bottled "Coke" under the Coca-Cola name within a prescribed territory; the bottling company in turn licensed several hundred sub-bottlers in specific territories within its overall territory. Attempting to terminate the contract with the bottling company, the original developer argued in part that if the contract were held to be perpetual by its terms, it would be void under the antitrust laws. The court held that the contract was perpetual, but not illegal; the restrictive covenants created partial restraints, merely ancillary to the main purpose of a lawful contract. Of particular interest in the present case is that court's statement that "the rights in good will and trade-mark name acquired under the contract by the bottlers were the same in character and as permanent as if . . . [the original developer of the syrup] had sold to them an established bottling business with its trade-marks and good will" (269 Fed. at 808).[43] It is noteworthy that the *Coca-Cola* case was decided about the time that Sugar Land Industries began its licensing program. See page 8, *supra*.

A number of additional decisions have upheld territorial restrictions attacked under the federal antitrust laws.[44]

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[43] Where, as here, there is no overriding illegal purpose, as the Attorney General's Antitrust Committee Report recognized, "valid trade-mark rights may provide a lawful main purpose to which reasonable restrictions on competition may be properly ancillary and therefore legal." Att'y Gen. Nat'l Comm. Antitrust Rep. 87 (1955).

[44] Phillips v. Iola Portland Cement Co., 125 Fed. 593 (8th Cir. 1903), *cert. denied*, 192 U.S. 606 (1904); Cole Motor Car Co. v.

United States v. *Columbia Pictures Corp.*, 189 F. Supp. 153 (S.D.N.Y. 1960), demonstrates the continued vitality of the ancillary restraints doctrine. The Government alleged that an exclusive distribution license involving two competing producers and the distributing subsidiary of one of them was illegal per se. The court rejected this contention, holding that the doctrine stated in the *Addyston Pipe* decision permits "business arrangements of benefit to the parties, and perhaps to the public, which have no injurious effect in the sense of antitrust policy." *Id.* at 178. The court summarized the rule as follows:

> "The doctrine of ancillary restraints . . . permits, as reasonable, a restraint which (1) is reasonably necessary to the legitimate primary purpose of the arrangement, and of no broader scope than reasonably necessary; (2) does not unreasonably affect competition in

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Hurst, 228 Fed. 280, 283-84 (5th Cir. 1915) (dealer restriction not anticompetitive because of abundance of inter-brand competition); Thoms v. Sutherland, 52 F.2d 592, 593, 596 (3d Cir. 1931); United States v. E. I duPont de Nemours & Co., 118 F. Supp. 41, 219-20 (D.Del. 1953), *aff'd,* 351 U.S. 377 (1956) (restriction on a joint venture company and its parents held reasonable); Beloit Culligan Soft Water Serv., Inc. v. Culligan, Inc., 274 F.2d 29, 32 (7th Cir. 1959) (restrictions on soft water service franchisees upheld, the court noting the good will developed by the licensees in their territories through substantial investments and expenditures); Engbrecht v. Dairy Queen Co., 203 F. Supp. 714, 715, 720 (D. Kan. 1962) (licensing of soft ice cream stands); Snap-On Tools Corp. v. FTC, 321 F.2d 825, 830-33 (7th Cir. 1963) (court acknowledged lessening of intra-brand competition among tool dealers, but found that system promoted inter-brand competition); Sandura Co. v. FTC, 339 F.2d 847 (6th Cir. 1964) (floor covering distributors could not be obtained or retained without territorial restrictions); Gray Line, Inc. v. Gray Line Sightseeing Companies Associated, 246 F. Supp. 495, 501 (N.D.Cal. 1965) (restriction on right to use name "Gray Line" upheld but restriction as to operating outside licensed area under other names held unreasonable).

the marketplace; and (3) is not imposed by a party or parties with monopoly power." *Ibid.*

The Government did not appeal the decision in *Columbia Pictures,* and does not attack it now, but rather attempts to distinguish it. However, the distinction which the Government attempts to draw is based upon a "fact" that it only claims to have "shown"—that "a permanent (or very long-term) territorial restriction like that at bar is in any event broader than reasonably necessary" (GB 22 n.13). A thorough search of the evidence cited by the Government, and indeed of the entire record, demonstrates that no such "fact" has been "*shown,*" and the Government attorneys should more accurately have said, "as we have *theorized.*"

In any event, their theorizing is unsound. It fails to recognize that, although long-range elimination of *all* competition between the contracting *parties* to the sale of a business may in some circumstances be considered unreasonable, a permanent covenant by the seller not to compete with the buyer of the business *under the name sold* is common business practice and no more than fairness demands. It is the latter kind of case—where Sealy licensees are restricted only as to the areas in which they may sell under the Sealy name—that is involved here. Moreover, Sealy licenses are not permanent, but are cancellable by Sealy upon a licensee's failure to maintain adequate facilities and selling efforts. See, *e.g.,* GX 1086, R. 1302-03; pp. 13-14, *supra.*

In the recent case of *Denison Mattress Factory* v. *Spring-Air Co.,* 308 F.2d 403 (5th Cir. 1962), the territorially restricted licenses of mattress manufacturer licensees were held not to violate the Sherman Act, notwithstanding the fact that the licensees had formed the licensor corporation and jointly owned its stock. The court found that "the primary purpose of the . . . agreement was not to avoid

the antitrust laws" and that, as here, "Denison's private brand products were not affected in any material manner by the agreement" (308 F.2d at 409). Rejecting a per se rule, the court followed a rule of reason approach, observing (*id.* at 413): "[a]n agreement which strengthens and promotes competition is not a violation of the law."[45]

Citing the *Denison Mattress* case with approval, the Federal Trade Commission recently reaffirmed and applied the ancillary restraints doctrine in upholding certain restrictive clauses in the agreements of a soft ice cream franchising organization. *Matter of Carvel Corp.*, 3 TRADE REG. REP. ¶ 17,298 (Dkt. 8574, July 19, 1965).

The original Sealy license agreements are a classic example of an ancillary restraint: Sugar Land Industries sold some of its manufacturing plants and granted to the purchasers the exclusive right to continued use of the Sealy name, trademark and processes in the areas which they served.[46] It licensed manufacturing plants in other areas in exchange for royalties (see p. 8, *supra*). Sealy and the other successors in interest to Sugar Land have continued to license the manufacture and sale of Sealy products in specified territories, and to furnish highly important ad-

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[45] This decision was noted with approval and quoted by the Select Committee on Small Business in its 1963 report following an investigation of the threatened application by the Federal Trade Commission of a per se rule to cooperative advertising by independent retail druggists groups. H.R. REP. No. 699, 88th Cong., 1st Sess. 14 (1963).

[46] In its brief in the *White Motor* case, the Government conceded that such restrictions, ancillary to the sale of a capital asset, may be lawful, but distinguished restrictions on resale of commodities. See Brief for United States, pp. 39-41, White Motor Co. v. United States, 372 U.S. 253 (1963). Here, the Government erroneously compares Sealy's restrictions to the latter. See note 53, *infra*.

vertising and management services, and they have made profits on the royalties received therefor.

The exclusive territory provision is *necessary* because licensees will not invest time and money to develop production facilities, a distribution system, and consumer acceptance for Sealy products without such protection. This is true even with respect to a temporary license for an area; as a licensee wrote Sealy:

> "In view of the fact that I know you have given serious thought to turning this territory over to a new franchise, I think I would be foolish to go in there and invest in a warehouse or spend much on advertising unless I had some agreement or understanding as to how long it would be before someone else would take it over. You will certainly agree on this." GX 192, p. 3-4789*.[47]

The district court found that territorial protection is "an essential inducement to prospective licensees—to get them to undertake the obligations of a Sealy license" (Fdg. 86, R. 91-92). One of those obligations is to make a continuing investment in advertising and promoting "Sealy" in the licensee's territory. See p. 13, *supra*.

Additionally, the territorial provision is necessary to reduce the risk of confusion of the public as to the source of products marked "Sealy," or with other Sealy trademarks, *e.g.* "Posturepedic," and thus supply protection against the danger of the marks' being rendered invalid. Under the Lanham Act, a trademark is used by a manufacturer "to identify his goods and distinguish them from those manufactured or sold by others" (15 U.S.C. §1127).

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[47] Another letter to Sealy noted that "to make ourselves perfectly safe before investing too much money in this territory, most certainly want it added to our present contract so we will be sure where we stand." GX 197, R. 462; see also pp. 12-16, *supra*.

The Government is correct (GB 18) in stating that modern trademark case law permits trademark licensing of different manufacturers, provided confusion of the public is avoided by devices which assure uniformity such as quality control. But its contention that removal of the territorial restriction would in no way render protection of the trademark more difficult is a gratuitous and greatly over-simplified assertion concerning technical trademark law concepts. Trademark licensing always presents hazards to the mark's validity.[48] Any method which insures a maximum degree of sameness in the products marketed under the trademark aids protection of the mark, as the Government itself points out. But the Government does not state the key point that it is uniformity in the *same market* that counts most, for it is only in a given market that non-uniformity will be confusing to the public. Indeed, the Lanham Act permits concurrent use of a trademark by non-related companies in different areas without any uniformity requirement (15 U.S.C. §1052), thus recognizing the critical importance of separateness of the market areas in which the mark is used. Sealy's territorial licensing restrictions should be viewed in light of these concepts, and argumentative assertions by the Government are no substitute for established trademark principles.[49]

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[48] See Nims, Unfair Competition and Trade-Marks §22 (4th ed. 1947); Denison Mattress Factory v. Spring-Air Co., 308 F.2d 403, 409 (5th Cir. 1962).

[49] In Matter of Carvel Corp., p. 38 *supra*, the FTC upheld use of ancillary competitive restrictions to insure uniformity in the relevant market, expressly recognizing that quality control alone may not be sufficient. As the Commission stated:

> "In a trademark situation, such as we are faced with here, the asserted justification for the challenged restrictions is primarily the need to achieve a specified quality of product and the avoid-

The exclusive territory provision, although containing no fixed term, is ***not unreasonable*** because it eliminates no competition which would otherwise exist.[50] The licensees are not competitors in the sale of Sealy-brand products until they receive their licenses, and they would not accept (or long continue to discharge) the obligations of Sealy licenses without territorial protection. Any competition, existing or potential, on their private brand goods is not affected by the Sealy licenses.[51] The district court noted that "[t]he definitions of 'Sealy products' in both the complaint and answer exclude private label bedding, and there is no allegation that any licensee was restrained in any way in his manufacture or sale of products bearing his own label" (Fdg. 4, R. 64).

The provision is ***fair*** because, having built up the Sealy name and good will in a certain area, and having identified goods of his manufacture thereunder, the licensee has made a substantial investment, and is entitled to protection against expropriation thereof by others offering their similar goods ***under that same name.*** The provision is in the ***public interest*** because it serves to increase inter-brand competition between Sealy licensees and manufacturers of other brands; and the Sealy program strengthens each licensee as an independent competitor with its own private-

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ance of consumer deception by supplying a uniform product at each Carvel store. Quality might be achievable by specifications whereas uniformity in all probability could not be" (3 TRADE REG. REP. ¶ 17,298 at p. 22,428).

[50] Sealy licenses are cancellable for inadequate performance (see p. 13, *supra*).

[51] Government counsel conceded that licensees sell their own-brand products outside their Sealy territories (R. 12).

brand business vis-a-vis other Sealy licensees (in their sale of both Sealy and private-brand products) and other bedding manufacturers.

II.

Adoption of a Per Se Rule in the Case at Bar Is Unwarranted and Contrary to the Public Interest

A. As in the *White Motor* Case, the Evidence Here Provides No Basis for Creating a Rule of Per Se Illegality

1. *The Government's Contentions Amount to an Effort to Reargue* White Motor

The record in the case at bar, made by the Government, totally fails to establish that Sealy's territorial restrictions have " 'a pernicious effect on competition and lack . . . any redeeming virtue' "—the test recognized by this Court for per se violations of the Sherman Act in *White Motor Co.* v. *United States,* 372 U.S. 253, 263 (1963). Indeed, as noted at pp. 17-18, *supra,* it was the Government's insistence at pretrial and at trial that it would prove a "hard-core" conspiracy that substantially prevented the discovery and offering of evidence to show "the actual impact of these arrangements on competition" (372 U.S. at 263).

Lacking evidence to show either that Sealy's manufacturing licenses were part of a scheme to divide markets, or that they in fact unreasonably restrain trade, the Government attempts to liken them to other arrangements which have been held illegal per se, and to claim that they could not be justified. Moreover, it urges that its postulations be accepted without supporting evidence, in the interests of "certainty," "simplification," and "judicial economy" (GB 9, 15, 16). The Government made almost identical arguments in *White Motor* in its unsuccessful effort to have

similar vertical territorial restrictions (imposed by manufacturers upon retail dealers) declared per se unlawful.

Thus, in *White Motor*, the Government argued that the restrictions "closely resemble" horizontal market division and resale price maintenance agreements (see 372 U.S. at 266);[52] here, it says that Sealy's arrangement "closely resembles the classic division-of-territories agreement" and is "much like" price fixing (GB 12, 15). The Court declined to accept the Government's thesis in *White Motor* since the record contained no evidence of the "purpose or effect" of the territorial restraints (372 U.S. at 263). Mr. Justice Brennan (concurring) noted significant differences between White Motor's dealer restrictions and horizontal market division, and he found the analogy to resale price agreements no less deceptive than the analogy to horizontal division of markets (372 U.S. at 267-68).[53]

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[52] Specifically, the Government argued that: "agreements between a manufacturer and his distributors providing for a division of markets among the distributors are as unlawful per se as a division among the distributors themselves" (Brief for the United States, p. 12, White Motor Co. v. United States, *supra*); and, "the anticompetitive consequences of such agreements are identical with the effects of horizontal divisions of the market" (*id.* at 18).

[53] Both in *White Motor* and here, the Government relied upon Dr. Miles Medical Co. v. Park & Sons Co., 220 U.S. 373 (1911), which outlawed resale price maintenance agreements (see 372 U.S. at 266 and GB 15). Mr. Justice Brennan, in his concurring opinion (372 U.S. at 268), rejected the analogy, observing that "the effect upon *inter*-brand competition is not necessarily the same as that of resale price maintenance." Donald F. Turner also distinguished the two situations in *The Definition of Agreement under the Sherman Act*, 75 HARV. L. REV. 655, 697-99 (1962). See also Note, *Restricted Channels of Distribution under the Sherman Act*, 75 HARV. L. REV. 795, 800-01 (1962). The opinion in the *Dr. Miles* case draws a distinction of singular importance in the present case. One of the prin-

The suggested distinction between *White Motor* and the instant case—that here, unlike a vertical restraint, "competition has in effect been eliminated by the . . . competitors themselves" (GB 12)—is invalid. The Government similarly argued in *White Motor* that the "effects" of White's vertical agreements were "identical with" those of a horizontal conspiracy (see note 52, *supra*). The argument was found to lack record support in *White Motor* (see 372 U.S. at 267 (concurring opinion)); here, the argument is refuted by the facts that, as shown above, (1) Sealy deals at arms length with its licensees, and (2) no competition that would otherwise exist has been eliminated (see p. 41, *supra*).

In sum, the Government seeks to relitigate the proposition that intra-brand territorial restraints are illegal per se without evidence of their economic significance, the very issue on which it lost in the *White Motor* case. Rejecting similarly speculative arguments for the establishment of a per se rule in that case, the Court reminded the Government that the " 'rule of reason' normally requires an ascertainment of the facts peculiar to the particular business." And the Court quoted a passage from *Chicago Board of*

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ciples relied on by the Court to invalidate control by a manufacturer over his customer's resale price was the public interest in "maintaining freedom of trade with respect to future sales after the article has been placed on the market and the producer has parted with his title." 220 U.S. at 403. But the Court distinguished the invalidity of a restraint upon alienation of an article of commerce from the principle that a "secret process may be the subject of confidential communication and of sale *or license to use with restrictions as to territory* and prices. *Fowle* v. *Park*, 131 U.S. 88." *Id.* at 402; emphasis added. Sealy's limited licenses of its manufacturing know-how, patents, trade name, and trademarks when originally granted were sanctioned by the Court's decision in *Dr. Miles.*

Trade v. United States, 246 U.S. 231, 238 (1918), that is again most appropriate in the present case:

> "The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts."

2. ***The Government's Economic Arguments Are Fallacious And No Need Is Shown For A Harsh New Rule of Per Se Illegality***

Even a superficial consideration of the facts peculiar to the business in which Sealy and its licensees are engaged, and the nature and extent of the restraint in question, reveals the unsoundness of the Government's position. Basically, the Government's aim is to force competition among Sealy's manufacturer licensees in selling "Sealy" products to dealers, just as it sought to require intra-brand competition among White's dealers in selling to retail truck buyers. And its economic "analysis" assumes that the costs and business problems which Sealy manufacturers face are the same as those of retail dealers.[54]

But Sealy's licensees are not in the position of *dealers;* Sealy's licensees are in the position of any manufacturer

[54] GB 12, 14, 18-19. It assumes, for example, that all Sealy manufacturers have similar, relatively fixed unit costs, rather than the differing costs of different manufacturers. Some expenses, such as how much to spend on advertising in a given area, are highly discretionary.

who *sells to dealers* and whose success depends upon maintaining a dealer distribution system. Each licensee's dealers are principally furniture and department stores, and mail order houses, who, like floor covering, tool, automobile, and other dealers in advertised manufactured goods, are accustomed to and insist upon a certain "franchise" of their own in their trading areas.[55] In turn, manufacturers are somewhat selective and usually place a reasonable limitation upon the number of dealers appointed to handle their brands in a particular area, and they provide those dealers with services such as merchandising, advertising, and promotional programs.[56] The retail dealer naturally limits the number of brands of a given item he features, and works with his suppliers to develop acceptance and push the sales of their products. It is in this way that manufacturers, including bedding manufacturers, establish distribution systems for their products.

A basic question here is whether or not Sealy licensees have the right to select and place reasonable limitations on the number of dealers they will appoint in their respective territories, as integrated manufacturers concededly

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[55] See Sandura Co. v. FTC, 339 F.2d 847, 850-53 (6th Cir. 1964); Snap-On Tools Corp. v. FTC, 321 F.2d 825, 831-32 (7th Cir. 1963). In the recent *GM* case, the Government did not attack the clause in GM dealer contracts permitting limitation of the location of dealers in an area, except insofar as it was construed to prevent all sales by dealers to discount houses. Brief for the United States, pp. 33-34, United States v. General Motors Corp., 384 U.S. 127 (1966); oral argument, 34 U.S.L. WEEK 3210 (U.S. Dec. 14, 1965).

[56] Sealy licensees plan with their respective dealers various selling campaigns and promotional sales, coordinating manufacturer and dealer advertising. Fully half of the Sealy licensees' sales volume is done during planned promotional sales, local and national (Bergmann, R. 25; pp. 5-6, *supra*). The Government makes no claim that the number of Sealy dealers is inadequate, or that competition among them is not vigorous.

have the right to do. If the Government's arguments here were to be accepted, the licensees would be denied this right; the dealer relationships of each Sealy licensee would be at the mercy of neighboring licensees, and his ability to wage inter-brand competition would be jeopardized.[57]

The reason for this is plain. Dealers in a given area expect, and under the law are entitled,[58] to receive non-discriminatory treatment in connection with their purchases of merchandise. They could count on this from Simmons and other integrated manufacturers; they could not from

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[57] Numerous businessmen, including various Sealy licensees and other mattress manufacturers, testified before a Senate Antitrust Subcommittee, that exclusive territories are necessary, and make possible competition by small manufacturers against the integrated giants. *Hearings on S. 1396 Before the Subcommittee on Patents, Trademarks, and Copyrights of the Senate Committee on the Judiciary,* 87th Cong., 1st Sess. 81-82, 86-87, 42, 45-46, 52, 57-58 (1961) [hereinafter cited as *Hearings on S. 1396*]; *Hearings on Distribution Problems Affecting Small Business, Franchising Agreements, Before the Subcommittee on Antitrust and Monopoly, Senate Committee on the Judiciary,* 89th Cong., 1st Sess., pt. 2 at 703-08, 713-15 (1966) [hereinafter *1965-66 Senate Franchise Hearings*]. Mr. Eugene Foley, then Administrator of the Small Business Administration, confirmed this necessity in his testimony before a Senate Antitrust Subcommittee:

> ". . . Hardly less important in many cases are territorial restrictions preventing each of a franchisor's outlets from selling in an area assigned to another.
>
> "Such fencing is a very effective method of encouraging each franchisee to advertise in his territory, secure in the knowledge that the soil thus fertilized will not be invaded by others. Further, it serves to direct the competitive energies of all the franchisees away from each other and against rival brands." *1965-66 Senate Franchise Hearings,* pt. 1 at 11-12 (1965).

[58] See Clayton Act, as amended by the Robinson-Patman Act §§2(a)-(f), 15 U.S.C. §§13(a)-(f).

Sealy if several Sealy licensees were (or might be) selling in an area. Thus, the dealers of one Sealy licensee could not be sure that they would receive allowances, services, promotional sales and the like, on Sealy merchandise comparable to those of other retailers who might buy (regularly or occasionally) from another Sealy licensee. Neither could they be sure—as they could be with Simmons—that a large number of additional Sealy dealers would not be appointed in the area. Moreover, Sealy dealers could not know what level of advertising and merchandising effort, if any, they could expect in the course of a selling season, in view of the fact that a neighboring licensee might "dump" Sealy goods in the area at prices reflecting manufacturing and delivery costs, but no advertising-merchandising expenses.[59] In a vigorously competitive market, what incentive would dealers have to handle and promote "Sealy" under such conditions—when normal services and more reliable relationships are available from integrated firms?

The Government attempts to minimize the fact that, without territorial restrictions, one licensee could "skim off the cream" by selling into the territory of neighboring licensees; it asserts that, owing to high shipping costs, each licensee "enjoys an inherent competitive advantage in his home area" (GB 19). This disregards other, more important elements of cost. For example, a licensee may be competing successfully against vigorous inter-brand competition with total advertising-merchandising-selling expenses of 25% of his sales dollar.[60] On a mattress whole-

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[59] Failure of the licensee to remain competitive pricewise would hasten deterioration of his dealer relationships.

[60] Sealy's Chicago licensee testified before a Senate subcommittee that his advertising-selling-administrative expenses run about 31% of sales. *Hearings on S. 1396* 80.

saling at $30.00, this amounts to $7.50. A neighboring licensee—*although incurring like expenses on sales in his home territory*—can pay several dollars of extra freight on each mattress and still sell into another licensee's territory at substantially reduced prices, and such sales will be "cost justified" because he has no advertising or merchandising expenses and minimal selling expenses thereon.[61] He takes a "free ride" on his neighbor's investment. Any short-range advantage to a few retailers and consumers from such selling would be more than outweighed by the long-range damage to the public from reduced inter-brand competition. Sealy licensees would be forced to eliminate or drastically reduce their local advertising and merchandising expenditures in support of the Sealy brand; they would soon have little alternative but to abandon "name brand" competition for "low end" (minimum quality, low priced) merchandise.[62]

The Government argues that under the Sealy arrangement, efficient licensees are penalized by not being permitted to invade the territory of other licensees (GB 20). *This is a complete fallacy.* To the extent that a Sealy licensee has manufacturing and selling ability, and efficiency, sufficient to serve an area greater than his Sealy territory, he is not restricted from doing so *on those merits and under*

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[61] Protected against "dumping" by other-brand competitors under the territorial price discrimination prohibitions of the Robinson-Patman Act (note 58, *supra*), a Sealy licensee would have little defense against such "cost justified" discriminations by neighboring Sealy licensees.

[62] Contrary to the Government's speculative assertion (GB 21), Sealy sales soon would decline, and its brand probably would disappear. See Sandura Co. v. FTC, 339 F.2d 847, 856 (6th Cir. 1964); Note, *Restricted Channels of Distribution under the Sherman Act*, 75 HARV. L. REV. 795, 811-13 (1962); Note, *Exclusive Territorial Arrangements and the Antitrust Laws*, 39 IND. L. J. 785, 791 (1964).

his own brand; he is restricted only from trading on the good will that has been built up by Sealy itself, and by other licensees, outside his licensed territory. To require, as would the Government, that a neighboring licensee be permitted to sell *Sealy* in his neighbor's territory is to encourage piracy, not competition.[63] It is precisely for this reason that territorial protection is essential if Sealy is to obtain and keep licensees.

The Government's argument that the success of Sealy, *e.g.*, through advertising,[64] may make it difficult for smaller,

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[63] Since the dissolution of Standard Oil in 1911, the separated companies have had the exclusive right to use the "Standard Oil" name and derivatives thereof, such as ESSO, in specific territories; the exclusivity of this right was recently reaffirmed in a dispute between two of the "Standard Oil" companies, in which an antitrust argument was made against the alleged resultant division of territories. Standard Oil Co. (Kentucky) v. Humble Oil & Ref. Co., 363 F.2d 945 (5th Cir. 1966), *petition for cert filed,* 35 U.S.L. Week 3187 (U.S. Nov. 22, 1966) (No. 765). The court of appeals said:

> "*The antitrust laws require competition, not piracy.* The essence of competition is the ability of competing products to obtain public recognition based on their own individual merit. A product has not won on its own merit if the real reason the public purchases it is that the public believes it is obtaining the product of another company. There is not now, nor has there ever been, a conflict between the antitrust laws and trademark laws or the law of unfair competition. *The antitrust laws could go no further than to envision Humble's entering the market and competing under one of its non-Standard Oil trade-names and marks. In this way Humble could obtain customers based on its own merits.*" *Id.* at 954, emphasis added.

Accord, Humble Oil & Ref. Co. v. American Oil Co., No. 63 C 251 (2), E.D. Mo., Sept. 29, 1966.

[64] Whether or not extensive national advertising is "at best, a mixed blessing" (GB 19) might be of interest to the Congress, but it is hardly a matter for consideration in this case.

local bedding firms to compete, ignores the potential destructive effect of the relief here requested. Sealy concedes that a small company per se cannot spend as much money for advertising as a large national company. But the Government's argument overlooks the fact that large, integrated national firms *are* in existence, and that these companies *do* engage in national advertising (see notes 23, 24, *supra*). *Programs such as Sealy's may be the only way for small mattress companies to compete with them.*[65] If territorial restrictions are necessary to the success of such programs—as the record here plainly indicates—then pursuing the Government's argument to a successful conclusion might well eventuate in leaving the quality bedding field almost exclusively to large national firms, a result entirely contrary to rational antitrust policy.

The Government concedes that it is "often desirable to encourage new entry" by permitting temporary territorial restrictions (GB 20). Having conceded that a territorial restriction limited in time may not unreasonably restrain trade, the Government is in a poor position to contend that such a restriction becomes per se unlawful simply because made for a longer, or unlimited, period of time. The same reasoning that supports the desirability of *inducing* a licensee to build a new plant or invest his time and money in introducing and promoting the sale of Sealy products in an area applies to the licensee's *maintaining* that plant and *continuing* to make that investment. Indeed, he cannot reasonably be expected to make the initial investment if at the end of a few years of cultivation, the fruits of his labor and capital can be harvested, or indeed destroyed, by others.[66]

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[65] There is nothing to prevent other small companies from forming competing advertising "groups."

[66] As the Court pointed out in the *White Motor* case, territorial restrictions "may be allowable protections against competitors or the

The Government's suggestion that each Sealy licensee would receive sufficient protection and better motivation if he were merely to "shoulder primary responsibility for cultivating a particular territory" (GB 20-21) proposes a most unrealistic solution to a very real business problem. A neighboring licensee can destroy another's dealer relationships and distribution system, and eliminate his incentive to advertise and merchandise Sealy products, just as much by sporadic raids as by day-to-day competition with the Sealy brand. Moreover, if Sealy were to enforce a primary responsibility clause (particularly at the request of a licensee), a most hazardous risk would be created of an implied conspiracy.[67]

Nowhere has the Government shown why territorial restrictions such as those here should be subjected to a rigid rule of per se illegality. Such a rule would be stricter than that which would be applied under Section 7 of the Clayton Act if Sealy and its licensees, with similarly legitimate motives, had entered into a like arrangement in the form of a joint venture.[68] It would also be stricter

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only practicable means a small company has for breaking into *or staying in business*" (372 U.S. at 263, emphasis added).

[67] *Cf.* United States v. Parke, Davis & Co., 362 U.S. 29 (1960); United States v. General Motors Corp., 384 U.S. 127 (1966); see Snap-On Tools Corp. v. FTC, 321 F.2d 825, 832 (7th Cir. 1963); Stewart, *Exclusive Franchises and Territorial Confinement of Distributors*, 22 A.B.A. Antitrust Section 33 (1963). If the licensees were to maintain an "armed truce," each staying in his own area of primary responsibility, but prepared to strike back if another made the first move, the economic effect would be identical to that of the present territorial restriction.

[68] In United States v. Penn-Olin Chemical Co., 378 U.S. 158 (1964), the Court held that competitive criteria should be considered in determining the legality of a joint venture, which, contrary to a

than the rules to be applied under Section 1 or Section 2 of the Sherman Act had they completely merged their businesses and been charged with being a combination in unreasonable restraint of trade,[69] or with monopolizing trade in "Sealy products."[70] Indeed, not even the standard governing "tying" arrangements, the use of which, it has been held, "can rarely be harmonized with the strictures of the antitrust laws . . ." (*Brown Shoe Co. v. United States*, 370 U.S. 294, 330 (1962)), is so rigid as the per se rule here urged. As the Court pointed out in *White Motor*, tying arrangements "may fall in . . . [the per se] category, though not necessarily so," noting the "importance of the nature of the tying arrangement in its factual setting" (372 U.S. at 262-63).

The law as it is can without question reach schemes designed to divide markets and fix prices (see note 27, *supra*), as well as those which, in operation, result in unreasonably restraining trade.[71] The drastic per se rule for which the Government contends here would outlaw *in addition* an untold number and variety of territorial arrangements which are of substantial importance to small businessmen, as we demonstrate in the following section.

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merger, "creates a new competitive force." *Id.* at 170, 176-77. In KAYSEN & TURNER, ANTITRUST POLICY 136-41, 144, 152-53 (1959), it is pointed out that joint ventures and joint selling or buying agencies should not be governed by a per se test; such factors as the amount of market power possessed by the venture and whether the members of a joint selling agency were required to sell all of their goods through the joint agency should be considered.

[69] See United States v. First Nat'l Bank & Trust Co. of Lexington, 376 U.S. 665, 671-73 (1964).

[70] United States v. E. I. duPont de Nemours & Co., 351 U.S. 377, 395 (1956).

[71] See, *e.g.*, United States v. Griffith, 334 U.S. 100 (1948).

B. Establishment of a Per Se Rule of Illegality for Territorial Restrictions Such as Sealy's Would Contravene the National Policy Favoring Vigorous Competition and the Fostering of Small Business

The Government's arguments ignore the importance of franchising in the United States today, and would apply hypertechnicalities in the name of the Sherman Act which would directly injure competition and jeopardize the thousands of small independent businessmen engaged in franchise programs[72]—a great many of which involve territorial restrictions.[73] The Government's per se approach would preclude the courts from determining whether or not the territorial restrictions of particular franchising programs are in fact anticompetitive. If the Government's arguments were accepted here, all license contracts similar to those used by Sealy would be suspect, if not illegal, regardless of the purpose of the parties, competition in the particular industry, or the competitive effect of the license. No such result should be countenanced without solid proof of unreasonableness of the restraint involved, and the Government has utterly failed to supply such proof in this case.

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[72] *Cf.* Standard Oil Co. v. United States, 337 U.S. 293, 315 (1949) (dissenting opinion). In Brown Shoe Co. v. United States, 370 U.S. 294, 316 (1962), the Court noted the national policy favoring "'local control' over industry and the protection of small business"; see also, *id.* at 346. Here, the Government's position would favor firms with the "longest purse" and cripple "smaller independents," contrary to the principles of United States v. Paramount Pictures, Inc., 334 U.S. 131, 164 (1948); *cf.* American Column & Lumber Co. v. United States, 257 U.S. 377, 413 (1921) (dissenting opinion).

[73] See Small Business Administration Management Research Report, Lewis & Hancock, The Franchise System of Distribution 9, 22-24 (1963); article by the General Counsel for the International Franchise Association, Rudnick, *Arbitration of Disputes between Franchisors and Franchisees,* 55 Ill. Bar J. 54, 56 (1966); testimony of Eugene P. Foley, then Administrator of the Small Business Administration at *1965-66 Senate Franchise Hearings* 11.

Since Sealy's territorial restrictions are necessary to its survival (pp. 39, 49-50, *supra*), an order enjoining their use would tend to destroy the vigor of inter-brand competition which is furnished to Simmons, Englander, and other integrated bedding manufacturers principally by licensee groups. Such an order would virtually foreclose formation of new groups and, in other industries as well as in bedding, it might well eliminate the only effective competition provided to dominant concerns, without any showing of justification therefor on the basis of economic facts or public necessity, contrary to the Sherman Act's "essential standard of reasonableness" (*Appalachian Coals, Inc.* v. *United States*, 288 U.S. 344, 359-60 (1933)).

It is noteworthy that in recent Senate hearings the Administrator of the Small Business Administration advocated a rule of reason approach to antitrust consideration of restraints such as those here in issue, and that the Chairman of the Federal Trade Commission did likewise, in clear disagreement with the arguments here advanced by the Antitrust Division of the Justice Department.[74]

The Government classifies the Sealy organization as a joint venture and concedes that not all restrictive agreements are illegal per se if adopted in such context, citing *United States* v. *Columbia Pictures Corp.*, 189 F. Supp. 153, 178 (S.D.N.Y. 1960) (GB 8, 25-26). The decision in that case,

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[74] *1965-66 Senate Franchise Hearings* 12-14. The Chairman of the Federal Trade Commission advised the same Senate subcommittee that the FTC does not view vertical territorial restrictions in franchising agreements as illegal per se, and he cited the *Snap-On Tools* case (note 67, *supra*) as "illustrative of the importance of the factual background of a franchise program and the industry in which it operates, in determining whether or not a territorial restriction arrangement is or is not reasonable." *Transcript of Hearings on S. 2549, Exclusive Territorial Franchise Bill, Before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary*, 89th Cong., 2d Sess. 173-75 (1966).

as well as those in *Appalachian Coals, supra,* and *United States* v. *Morgan,* 118 F. Supp. 621, 688-91 (S.D.N.Y. 1953), attest the flexibility of the Sherman Act to accommodate various types of joint ventures that meet business problems without anticompetitive results and without a dominant purpose of avoiding competition.[75]

It is no answer for the Government to say that the case at bar is unusual in that the licensees, in the aggregate, own most of the stock of Sealy, the licensor. If a "conspiracy" can be found under the present facts, the rule can be little different where the licensor is not so "controlled"; a manufacturer—the Government could argue, with some justification—"can fare no better with its plan of identical contracts than could the dealers themselves. . . ."[76] But, in any event, the legality of a bona fide franchising arrangement should not depend upon who owns the franchisor.

The development of the franchising system as a vital element in the American economy has met the needs of small businessmen for a means to compete with giant integrated firms. It can be compared to the evolution of the business corporation as a means for aggregating capital to meet the demands of the industrial revolution.[77] The Small Business Administration recently stated:

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[75] *Cf.* Timken Roller Bearing Co. v. United States, 341 U.S. 593, 597 (1951). See also note 68 *supra.*

[76] Dr. Miles Medical Co. v. Park & Sons Co., 220 U.S. 373, 408 (1911). The Government made this argument in *White Motor,* as we have shown (see note 52 *supra*). *Cf.* Interstate Circuit, Inc. v. United States, 306 U.S. 208, 226-27 (1939).

[77] See Stocking & Watkins, Monopoly and Free Enterprise 417 (1951); 1 Fletcher, Private Corporations 5-10 (rev. vol. 1963); Berle & Means, The Modern Corporation and Private Property 127-52 (1948).

"... Franchising contributes significantly to the ability of small concerns to compete effectively with larger organizations; ... it offers a relatively safe and promising haven for the small businessman; ... it provides business opportunities, otherwise unavailable, for many persons including members of minority groups, and ... it is a socially preferable alternative to the further vertical integration of the American economy since it brings to the economy and society most of the benefits and few of the evils thereof." 31 Fed. Reg. 11973 (1966).[78]

An example of the great contribution made to our society by the franchise movement is the "cooperative" and "voluntary group" grocery wholesalers movement, which has provided strong competition in food distribution for the giant integrated chain store firms. The recent report of the National Commission on Food Marketing noted:

"The success of the chains badly hurt independent food distributors, both wholesale and retail, in the

[78] The then Administrator of the Small Business Administration recently testified to like effect before a Senate subcommittee, concluding that, "as . . . [franchising's] explosive growth indicates, it may prove to be the most effective system yet devised to counter the market domination of the chains." *1965-66 Senate Franchise Hearings* 7-8. Similarly, Judge Dawson stated in Susser v. Carvel Corp., 206 F. Supp. 636, 640 (S.D.N.Y. 1962), *aff'd*, 332 F.2d 505 (2d Cir. 1964), *dismissed because cert. improvidently granted*, 381 U.S. 125 (1965):

"The franchise method of operation has the advantage, from the standpoint of our American system of competitive economy, of enabling numerous groups of individuals with small capital to become entrepreneurs. . . . The franchise system creates a class of independent businessmen; it provides the public with an opportunity to get a uniform product at numerous points of sale from small independent contractors, rather than from employees of a vast chain." 206 F. Supp. at 640.

early decades of the century. In response, independents developed their own integrated operations. Some groups of independent retailers created cooperative wholesale units to supply them with merchandise. In other cases, wholesalers assembled 'voluntary groups' of retailers into chain-type organizations. These affiliated independent groups adopted most of the methods used by chains." FOOD FROM FARMER TO CONSUMER, REPORT OF THE NAT'L COMM'N ON FOOD MKTG 69 (June 1966).[79]

The "voluntary" heaquarters (licensor) provides its wholesaler members with the same kind of services provided by other franchisors.[80] These services—*e.g.*, in the areas of advertising and merchandising, financial aid, quality and performance standards and controls, management and accounting—enable the small wholesaler to compete effectively with the larger concerns skilled in modern marketing and business methods.[81]

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[79] Another study of the development of the food industry states that "voluntary groups . . . . were a direct reaction to the encroachment of the corporate chains. The pioneer organizations—IGA, Red and White, Clover Farm, and others—were, in effect, national or regional headquarters organizations for the local voluntary wholesale grocers." HAMPE & WITTENBERG, THE LIFELINE OF AMERICA 299 (1964). See PALAMOUNTAIN, THE POLITICS OF DISTRIBUTION 79 (1955): "Arising in the 1920's, [voluntary chains and retailer cooperative warehouses] . . . attempted to secure for independent grocers many of the advantages of chains. They were designed to preserve individual store ownership and yet permit retailers to copy many chain methods, . . ." See also MUELLER & GAROIAN, CHANGES IN THE MARKET STRUCTURE OF GROCERY RETAILING 37-47 (1961).

[80] *Compare* FTC STAFF REPORT, ECONOMIC INQUIRY INTO FOOD MARKETING pt. I, at 214 (1960), *and* HAMPE & WITTENBERG, *op. cit. supra* note 79, at 306-11, *with* LEWIS & HANCOCK, *op. cit. supra* note 73, ch. III, *and* FRANCHISING TODAY (Vaughn & Slater ed. 1965).

[81] See LEWIS & HANCOCK, *op. cit. supra* note 73, at 67-69; MUELLER & GAROIAN, *op. cit. supra* note 79, at 106-08; *1965-66 Senate Franchise Hearings* 7-9.

Since 1947, while sales by wholly independent grocers have greatly declined, sales by retail grocery stores affiliated with cooperatives and voluntaries have grown rapidly until they now approximate the total chain store sales volume.[82]

In 1958, Independent Grocers' Alliance (IGA), one of the "national headquarters" groups, had 53 affiliated sponsor-wholesalers, who in turn dealt with 4,493 sponsored retail stores.[83] Each of these wholesalers was exclusively licensed as an IGA wholesaler within a designated territory, and was expressly prohibited from selling IGA merchandise and from enrolling stores as IGA retailers outside of its territory.[84] Such territorial restrictions are common, as indicated by authorities previously cited (*supra* note 73), and, of course, where the licensor is cooperatively owned by sponsor-wholesalers, the situation is not unlike that complained of here.[85]

The Government's attempt to create a rule of per se unreasonableness for testing restraints such as those in the Sealy license agreements should be rejected. Only a rule of reason approach will provide a necessary measure of protection for the numerous franchising programs that have developed in the United States. These programs are

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[82] HAMPE & WITTENBERG, *op. cit. supra* note 79, at 306-07; see FOOD FROM FARMER TO CONSUMER, *op. cit. supra* p. 58, at 70.

[83] FTC STAFF REPORT, *op. cit. supra* note 80, at 214-15.

[84] FTC STAFF REPORT, *op. cit. supra* note 80, at 315-20.

[85] *Cf.* Denison Mattress Factory v. Spring-Air Co., 308 F.2d 403 (5th Cir. 1962), p. 37, *supra,* in which territorial licenses were upheld, notwithstanding ownership of the licensor by the licensees. In the *Gray Line* case, *supra* note 44, and Wilbert W. Haase Co. v. Sultz, 43 TRADEMARK REP. 841 (W.D.N.Y. 1953) (burial vaults), the licensees also owned the licensor. See also, Central Retailer-Owned Grocers, Inc. v. FTC, *supra* note 35.

not designed to eliminate competition and typically do not possess significant market power; on the contrary, they may constitute the nation's best hope for preserving competition and avoiding increased concentration of market power in the hands of the few in many lines of commerce.

III.

Justice Requires that the Government Be Barred from Injecting Its New Theory of Per Se Illegality into this Case for the First Time on this Appeal

As we have shown, because the Government insisted upon its theory of per se violation of the Sherman Act and was successful in blocking Sealy's efforts to discover and present evidence as to industry data (see pp. 17, 42, *supra*), Sealy was not permitted to develop and adduce proof of the economic justification for and the procompetitive effect of its licensing program. Unquestionably, had the Government revealed to the trial court that it was not relying entirely upon a theory that Sealy and its licensees were engaging in a conspiracy, the central and main purpose of which was to allocate territories and suppress competition among Sealy licensees, pretrial discovery and the taking of evidence would have followed a different course. Had the Government informed the court that, absent proof of a hard-core conspiracy, it was also contending that the territorial restrictions (irrespective of the purpose or intent of Sealy and its licensees) amount to a per se violation of the antitrust laws by virtue of the substantial ownership of Sealy stock by the licensees, the trial court undoubtedly would have permitted Sealy to discover and present proof as to the actual impact of the territorial restrictions upon competition.

But, having chosen its hard-core theory of conspiracy intentionally aimed at restraining competition, and having utterly failed to prove it, rudimentary principles of law

and justice dictate that the Government should not now be permitted to argue its case on a new theory, relying on inference and innuendo in place of evidence it kept out of the record.

If the trial court had prevented the Government from trying to show that in actual effect and practice Sealy's territorial restrictions were unreasonable restraints of trade, the situation might be different. But here the Government at all times insisted that such matters were wholly irrelevant and succeeded in obtaining rulings by the lower court preventing discovery and presentation of such matters by Sealy. Under these circumstances, the Court should not entertain the Government's new theory on the same principle as that stated in *Giordenello* v. *United States*, 357 U.S. 480, 488 (1958):

> "We do not think that these belated contentions are open to the Government in this Court and accordingly we have no occasion to consider their soundness. To permit the Government to inject its new theory into the case at this stage would unfairly deprive petitioner of an adequate opportunity to respond."[86]

Moreover, sound judicial administration precludes a remand for the Government to attempt to prove its new theory to the district court. Sealy has been tried and found not guilty of the charge against it. For the Government to be given another opportunity—a "fourth strike"—to attempt to prove some theoretical anticompetitive effects from its licensing system would amount to harassment of a company that can ill afford such repeated litigation.[87]

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[86] *Cf.* Lawn v. United States, 355 U.S. 339, 362 n.16 (1958); Duignan v. United States, 274 U.S. 195, 200 (1927).

[87] Obviously, having conceded at trial that there was "plenty of competition" in the bedding industry, the Government had no evidence that Sealy's arrangement in fact unreasonably restrained trade.